

## Message Text

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ACTION EB-04

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FM AMEMBASSY BONN

TO SECSTATE WASHDC PRIORITY 3351

DEPARTMENT TREASURY PRIORITY

INFO USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 01 OF 03 BONN 19458

LIMDIS - GREENBACK

DEPARTMENT PASS FEDERAL RESERVE

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: GERMAN MONETARY POLICY

1. SUMMARY: WHILE THE BUNDESBANK IS CONVINCED THAT THE GERMAN ECONOMY IS NOW AGAIN ON AN UPWARD TREND, NO CLEAR LINE HAS AS YET EMERGED WHAT IMPLICATIONS SHOULD BE DRAWN FROM THIS FOR MONETARY POLICY. SOME BOARD MEMBERS APPARENTLY FAVOR AT LEAST MILDLY RESTRICTIVE STEPS (PROBABLY THROUGH OPEN MARKET POLICY) IN ORDER TO PRESERVE SOME CREDIBILITY FOR THE ANNUAL MONETARY GROWTH TARGETS (CURRENT INDICATIONS ARE THAT THE 1976 TARGET MAY BE EXCEEDED BY AS MUCH AS 15 PERCENT). OTHERS FEEL THAT IN VIEW OF THE GOOD CURRENT PRICE PERFORMANCE AND THE POSSIBLE FRAGILITY OF THE UPSWING RESTRICTIVE STEPS SHOULD BE AVOIDED OR POSTPONED. INTERNAL DISCUSSION IS NOW ALSO PROCEEDING ON THE 1977 MONETARY GROWTH TARGET WITH INFLUENTIAL MEMBERS OF THE BUNDESBANK BOARD FEELING THAT IN VIEW OF THE PROJECTED LOWER ECONOMIC GROWTH AND THE HIGH MONETARY OVERHANG, THE 1977 TARGET SHOULD

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BE BELOW THE 8 PERCENT 1976 TARGET. OTHERS SHY AWAY

FROM THE RESTRICTIVE POLICY STANCE THAT THIS WOULD IMPLY (WE CALCULATE THE AVERAGE GROWTH IN 1977 CENTRAL BANK MONEY AT 4.9 PERCENT EVEN IF NO FURTHER GROWTH OCCURS DURING THAT YEAR OVER THE LEVEL LIKELY TO BE REACHED THIS DECEMBER). PLEASE TREAT THIS REPORT ON INTERNAL GERMAN POLICY DELIBERATIONS STRICTLY NOFORN. END SUMMARY.

2. IN CONVERSATIONS THIS WEEK WITH THE FINANCIAL ATTACHE BOTH BUNDESBANK VICE PRESIDENT EMMINGER AND BOARD MEMBER SCHLESINGER (IN CHARGE OF ECONOMIC RESEARCH) EXPRESSED THEIR FIRM VIEW THAT THE GERMAN ECONOMY IS AGAIN ON A MODERATE UPWARD TREND. BOTH SAW CLEAR SIGNS THAT PRIVATE INVESTMENT IS BEGINNING TO PICK UP AGAIN (MAINLY DATA ON NEW ORDERS AND BANK LOANS) AND SAW NO REASONS WHY THIS TREND SHOULD NOT CONTINUE IN 1977. IN ADDITION, SCHLESINGER FELT THAT AN INSUFFICIENT SEASONAL ADJUSTMENT HAD EXAGGERATED THE EXTENT OF THE SUMMER LULL. FOR 1977 THE BUNDESBANK NOW FORESEES A 5.0 PERCENT REAL AND 9.0 PERCENT NOMINAL GROWTH IN GNP WITH THE DEVELOPMENT OF VARIOUS COMPONENTS GENERALLY FOLLOWING THAT FORECAST BY THE FOUR ECONOMIC RESEARCH INSTITUTES (SEE BONN 18236) EXCEPT FOR SOMEWHAT SLOWER EXPORT GROWTH. BOTH EMMINGER AND SCHLESINGER (AS ARE BONN ECONOMIC POLICY OFFICIALS) WERE HIGHLY CRITICAL OF THE RECENT OECD SECRETARIAT PROJECTIONS FOR THE GERMAN ECONOMY. THE USUAL OECD SECRETARIAT BIAS IS PARTICULARLY UNWELCOME AT THIS TIME WHEN BUSINESS CONFIDENCE IS A CRITICAL FACTOR IN FUTURE DEVELOPMENTS. SCHLESINGER PARTICULARLY CRITICIZED OECD'S RELIANCE ON THE IFO BUSINESS CLIMATE INDEX WHICH HE CHARACTERIZED AS A TWO-YEAR FORWARD INDICATOR FOR BUSINESS INVESTMENT AND PRACTICALLY IRRELEVANT FOR SIX-MONTH OR ONE-YEAR PROJECTIONS.

3. CONVERSATIONS WITH OTHER BUNDESBANK BOARD (PLEASE PROTECT AND TREAT STRICTLY NOFORN) MEMBERS INDICATED THAT WHILE THE BOARD GENERALLY GOES ALONG WITH THE SCHLESINGER VIEWS ON THE CURRENT STATUS OF THE ECONOMY  
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AND THE 1977 PROJECTIONS, IT DOES NOT FULLY SHARE HIS CERTAINTY. CONSIDERABLE DEBATE CLEARLY HAS BEEN GOING ON WITHIN THE BUNDESBANK BOTH CONCERNING MONETARY POLICY DURING THE REMAINDER OF 1976 AND CONCERNING THE 1977 MONETARY GROWTH TARGET. CONCERNING 1976, IT NOW LOOKS AS IF THE AVERAGE GROWTH IN CENTRAL BANK MONEY WILL COME TO ABOUT 9.2 PERCENT INSTEAD OF THE 8 PERCENT TARGET ANNOUNCED LAST DECEMBER. THE 1975

GROWTH TARGET ALSO WAS OVERSHOT BY A LARGE MARGIN.  
THE "HAWKS" IN THE CENTRAL BANK COUNCIL APPARENTLY  
ARE ARGUING THAT IF MONETARY GROWTH TARGETS ARE TO

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ACTION EB-04

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TO SECSTATE WASHDC PRIORITY 3352

DEPARTMENT TREASURY PRIORITY

INFO USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 02 OF 03 BONN 19458

LIMDIS - GREENBACK

RETAIN ANY CREDIBILITY THE BUNDESBANK MUST NOW DO  
SOMETHING TO CURB THE GROWTH OF CENTRAL BANK MONEY  
(EVEN IF SUCH A STEP PRESUMABLY WOULD BE LARGELY  
SYMBOLICAL AS FAR AS ACTUAL 1976 AVERAGES ARE  
CONCERNED). THE "DOVES" (WHO APPARENTLY INCLUDE  
PRESIDENT KLASSEN) ON THE OTHER HAND ARE LESS CERTAIN  
REGARDING THE FIRMNESS OF THE ECONOMIC UPTURN AND  
DO NOT WISH TO DO ANYTHING TO ENDANGER IT THROUGH  
MONETARY ACTION.

4. DURING NOVEMBER, FOREIGN EXCHANGE OUTFLOWS  
(INCLUDING DM PURCHASES BY SNAKE CENTRAL BANKS) AND  
BUNDESBANK OPEN MARKET SALES OF GOVERNMENT BONDS  
HAVE IN THE BOARD'S VIEW SUFFICIENTLY COUNTERBALANCED  
WITHDRAWALS OF GOVERNMENT FUNDS FROM THE CENTRAL  
BANK SYSTEM. DURING DECEMBER THE BUNDESBANK DOES  
NOT EXPECT ANY FURTHER MAJOR WITHDRAWALS OF GOVERNMENT  
FUNDS FROM THE CENTRAL BANK SYSTEM BOTH BECAUSE THESE  
ACCOUNTS NOW HAVE BEEN SUBSTANTIALLY RUN DOWN AND

ALSO BECAUSE MEDIUM AND LONGER TERM MONEY IS AVAILABLE  
AT RELATIVELY ATTRACTIVE RATES IN THE MARKET. ON  
THE OTHER HAND, THE BUNDESBANK DOES NOT HAVE ANY  
INDICATION THAT THE PUBLIC AUTHORITIES ARE LIKELY  
TO BORROW SIGNIFICANTLY IN DECEMBER TO PREFINANCE  
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1977 EXPENDITURES AND CONSIDERS THIS UNLIKELY BOTH  
BECAUSE (A) THE PUBLIC AUTHORITIES ARE LOATH TO PAY  
INTEREST ON SUCH BORROWING AND - AS THEY ARE OBLIGED  
TO - THEN KEEP THE PROCEEDS IN INTEREST FREE CENTRAL  
BANK ACCOUNTS AND (B) THE PUBLIC AUTHORITIES ARE NOW  
BEGINNING TO BE AFFECTED BY THE GENERAL FEELING IN  
THE MARKET THAT LONG TERM INTEREST RATES ARE DECLINING  
AND THAT IT IS THEREFORE DESIRABLE TO HOLD OFF ON THE  
TAKING UP OF LONGER TERM DEBT.

5. IN THIS SITUATION, THE FEDERATION IS NOT EXPECTED  
TO TAKE UP VERY MUCH DEBT BEYOND ITS DECEMBER NEEDS.  
THE ONLY QUESTION CURRENTLY UNDER DISCUSSION IS  
WHETHER INSTEAD OF USING THE BUNDESBANK "KASSENKREDIT"  
IT NORMALLY USES TO FINANCE JANUARY WAGE AND SALARY  
PAYMENTS, THE FEDERATION WILL THIS YEAR PREFINANCE  
THESE BY TAKING UP THE MONEY DURING DECEMBER ON THE  
MARKET.

6. DURING NOVEMBER THE BUNDESBANK HAS FAIRLY WELL  
EXHAUSTED ITS SCOPE FOR OPEN MARKET SALES OF  
GOVERNMENT BONDS OUT OF ITS PROTFOLIO. WHILE THE  
BUNDESBANK BALANCE SHEET STILL SHOWS ABOUT  
DM 2 BILLION OF SUCH BONDS REMAINING IN ITS  
PORTFOLIO, THE BUNDESBANK'S EXPERTS TELL US THAT  
THESE ARE SPREAD BETWEEN 120 DIFFERENT ISSUES, MANY  
OF WHICH CONTAIN CONDITIONS WHICH FOR ONE REASON OR  
ANOTHER MAKE THEM LESS MARKETABLE. LARGE SCALE OPEN  
MARKET OPERATIONS, IF THEY WERE DECIDED UPON, IN THE  
FUTURE WOULD HAVE TO BE CONCENTRATED IN CONVERTED  
EQUALIZATION CLAIMS AND LIQUIDITY PAPER (SEE BONN  
18252 AND BONN 5953). EVERYONE THE FINANCIAL ATTACHE  
TALKED WITH AT THE BUNDESBANK IMPLIED THAT IF SOME  
RESTRICTIVE MONETARY ACTION WERE DECIDED UPON IN THE  
NEAR FUTURE, IT WOULD BE MORE LIKELY TO TAKE THE FORM  
OF OPEN MARKET OPERATIONS RATHER THAN AN INCREASE IN  
MINIMUM RESERVES OR DISCOUNT AND LOMBARD RATES.

7. WHILE AT LEAST PART OF THE BUNDESBANK BOARD HAS  
BEEN UNHAPPY WITH RECENT EXTREMELY LOW MONEY MARKET  
RATES, ALMOST EVERYONE HAS BASICALLY WELCOMED THE  
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DROP IN LONG TERM INTEREST RATES, PARTICULARLY SINCE THERE HAS BEEN SOME FEELING (NOT UNANIMOUSLY SHARED) THAT THE RECENT RELATIONSHIP BETWEEN PROFIT EXPECTATIONS AND LONG TERM INTEREST RATES HAS LED TO A PREFERENCE BY A SIGNIFICANT NUMBER OF ENTERPRISES FOR FINANCIAL RATHER THAN PLANT AND EQUIPMENT INVESTMENTS. NEVERTHELESS BUNDESBANK EXPERTS FEEL THAT THE CAPITAL MARKET DURING RECENT WEEKS HAS BEEN CHARACTERIZED BY SPECULATIVE EXCESSES IN WHICH EVERYONE IS COUNTING ON A FURTHER DROP IN LONG TERM INTEREST RATES.

8. TRADITIONALLY (I.E., DURING THE LAST TWO YEARS) THE BUNDESBANK HAS ANNOUNCED ITS MONETARY GROWTH TARGET FOR THE FOLLOWING YEAR AROUND THE MIDDLE OF DECEMBER. THIS YEAR AGREEMENT ON A GROWTH TARGET FOR 1977 APPARENTLY IS PARTICULARLY DIFFICULT. ON THE ONE HAND, THE PROJECTED SLOWDOWN IN ECONOMIC GROWTH AND THE "MONETARY OVERHANG" CREATED BY THE

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TO SECSTATE WASHDC PRIORITY 3353

DEPARTMENT TREASURY PRIORITY

INFO USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 03 OF 03 BONN 19458

LIMDIS - GREENBACK

OVERSHOOTING OF THE 1976 TARGET ARGUE FOR A LOWER  
FIGURE THAN THE 8 PERCENT 1976 TARGET FOR THE GROWTH  
IN THE AVERAGE OF CENTRAL BANK MONEY OVER THE  
AVERAGE OF THE PREVIOUS YEAR. IMPORTANT BOARD MEMBERS  
FEEL THAT UNLESS THE CENTRAL BANK COUNCIL PICKS A  
LOWER THAN 8 PERCENT TARGET FOR 1977, THE BUNDESBANK  
LOOSES CREDIBILITY AS A GUARDIAN OF PRICE STABILITY  
AND ALSO MAY LOSE ITS MODERATING INFLUENCE ON WAGE  
DEVELOPMENTS. OTHERS, AND PARTICULARLY THOSE WHO  
ARE NOT YET FULLY CONVINCED OF THE SOLIDITY OF THE  
ECONOMIC UPTURN, SHY AWAY FROM THE RESTRICTIVE  
POLICY THAT A LOWER THAN 8 PERCENT GROWTH TARGET  
IMPLIES AND MIGHT SIGNAL TO THE BUSINESS COMMUNITY.  
(COMMENT: WE CALCULATE THAT IF THE GROWTH OF THE  
AVERAGE IN CENTRAL BANK MONEY  
DURING 1976 OVER 1975 IN FACT AMOUNTS TO THE 9.2  
PERCENT THE BUNDESBANK NOW PROJECTS, THEN THE  
MAINTENANCE DURING ALL OF 1977 OF THE LIKELY LEVEL  
OF SEASONALLY ADJUSTED CENTRAL BANK MONEY REACHED IN  
DECEMBER OF 1976--WITHOUT ANY GROWTH DURING 1977--  
ALREADY WOULD YIELD A GROWTH OF 4.9 PERCENT IN  
THE 1977 AVERAGE OVER THE 1976 AVERAGE.)  
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## Message Attributes

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